

## Message Text

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ORIGIN EB-08

INFO OCT-01 EUR-12 ISO-00 FEA-01 ERDA-05 AID-05 CEA-01  
CIAE-00 COME-00 EPG-02 DODE-00 FPC-01 H-01 INR-07  
INT-05 L-03 NSAE-00 NSC-05 OMB-01 PM-05 USIA-06  
OES-07 SP-02 SS-15 STR-04 TRSE-00 ACDA-07 PA-01  
PRS-01 /106 R

DRAFTED BY EB/ORF/FSE:PEBARBIAN:MEP  
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EUR/CAN:JBROH-KAHN  
-----091601 270630Z /21  
R 270207Z JUL 77  
FM SECSTATE WASHDC  
TO AMEMBASSY OTTAWA

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E.O. 11652: N/A

TAGS: ENRG, CA

SUBJECT: NORTHERN TIER OIL SUPPLY - MALIN VISIT

1. FEA ASSISTANT ADMINISTRATOR FOR INTERNATIONAL AFFAIRS, CLEM MALIN PLANS TO VISIT OTTAWA ON FRIDAY, JULY 29. MALIN WILL PROBABLY BE ACCOMPANIED BY M. SOLOMON, DIRECTOR, OFFICE OF CRUDE OIL OPERATIONS, AND BY STAFF MEMBER DON ALBERT. THE GROUP HAS ARRANGED A MEETING WITH D. HUNT OF EMR.

2. MALIN PREPARED A BRIEFING PAPER FOR O'LEARY ON HIS VISIT TO OTTAWA. TEXT OF MEMO IS PROVIDED FOR THE EMBASSY'S INFORMATION.

3. BEGIN TEXT:  
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BACKGROUND

DURING THE WEEK OF JULY 25, I EXPECT TO MEET IN OTTAWA WITH MY COUNTERPART IN THE CANADIAN MINISTRY OF ENERGY, MINES AND RESOURCES TO SEEK A RESOLUTION OF THE SHORT-TERM NORTHERN TIER PROBLEM IN GENERAL ;

AND TO DISCUSS THE ANALYSES YOU SENT TO MINISTER GILLESPIE  
ON JULY 11 IN PARTICULAR. ACCOMPANIED BY MEMBERS OF MY

STAFF AND THE STATE DEPARTMENT, I PLAN TO PRESS THE  
CANADIANS TO APPROVE OFFSHORE EXCHANGES AT MONTREAL.

AS YOU KNOW, THIS ISSUE POSES DIFFICULT QUESTIONS FOR  
THE CANADIANS--CAN THEY BACK CANADIAN OIL OUT OF THE  
SARNIA/MONTREAL PIPELINE TO SEND TO THE UNITED STATES  
IN RETURN FOR EITHER DOMESTIC U.S. OR FOREIGN OIL, GIVEN  
AMONG OTHER FACTORS, THE SENSITIVITY OF QUEBEC PROVINCE?  
IF THE ANSWER IS NO--AND THERE ARE INDICATIONS FROM  
AMBASSADOR ENDERS AND OTHERS THAT IT MAY BE NO--WE MUST  
EXPLORE ALTERNATIVE SOLUTIONS.

#### CANADIAN OPTIONS

CANADA HAS ESSENTIALLY ONLY TWO OPTIONS FOR SUPPLYING  
ADDITIONAL OIL TO THE NORTHERN TIER:

1) DIVERSION: REDIRECTING CANADIAN OIL NOW FLOWING TO  
MONTREAL (VIA THE SARNIA/MONTREAL PIPELINE) OR TO  
VANCOUVER (VIA THE TRANSMOUNTAIN PIPELINE) OR,

2) INCREASING DOMESTIC CANADIAN PRODUCTION: CANADA HAS  
JUST OVER 300,000 B/D OF SHUT IN PRODUCTION. ALMOST ALL  
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OF THIS OIL IS LIGHT AND COULD THEREFORE BE USED BY THE  
NORTHERN TIER REFINERS. AN INCREASE IN PRODUCTION OF ONLY  
50 MB/D OF LIGHT CRUDE OIL COULD GREATLY ALLEVIATE THE  
U.S. PROBLEM UNTIL A PERMANENT SOLUTION WAS IN PLACE, SAY,  
WITHIN THREE YEARS.

DIVERSION: EXCHANGES AT VANCOUVER

IF CANADA REFUSES TO DIVERT OIL NOW FLOWING FROM ALBERTA  
TO MONTREAL, THE CANADIANS MIGHT CONSIDER AN EXCHANGE  
AT VANCOUVER. WHILE THERE ARE SIMILARITIES BETWEEN  
MONTREAL AND VANCOUVER OPTIONS, THERE ARE ALSO SIGNIFICANT  
DIFFERENCES.

THE REFINERS OF VANCOUVER HAVE HISTORICALLY OBTAINED  
ALBERTA SWEET CRUDE VIA THE TRANSMOUNTAIN PIPELINE.  
THEIR COMBINED CAPACITY IS 125,000 B/D. A PORTION OF  
THIS VOLUME COULD BE BACKED OUT WITH FOREIGN OIL  
(INDONESIAN, ALGERIAN OR LIBYAN) OR U.S. WEST COAST  
SWEET CRUDES (COOK INLET OR STEVENS ZONE FROM ELK HILLS)  
WITH THE RESULTING CANADIAN PRODUCTION FLOWING TO THE  
U.S. NORTHERN TIER.

HOWEVER, CANADA'S ANNOUNCED POLICY ON THIS ISSUE IS:

1) TO MINIMIZE IF NOT COMPLETELY EXCLUDE TANKERS FROM PUGET SOUND; AND

2) AS DOMESTIC PRODUCTION DECLINES, CONTINUE SUPPLYING OIL TO B.C. AT THE EXPENSE OF QUEBEC AND ONTARIO.

CONSEQUENTLY, IT IS HIGHLY UNLIKELY THAT CANADA WILL GO AGAINST ITS LONG-STANDING POLICY ON THIS ISSUE AND ALLOW EXCHANGES AT VANCOUVER, UNLESS THEY CONTEMPLATE SIMILAR ACTION ON THE TRANSMOUNTAIN "YO-YO" PROPOSAL OR THE U.S. COMMITS TO A LONG-TERM SOLUTION WHICH ENDS TANKER TRAFFIC LIMITED OFFICIAL USE

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IN PUGET SOUND.

INCREASING DOMESTIC PRODUCTION

THE CANADIAN NATIONAL ENERGY BOARD CONTROLS THE EXPORT OF CANADIAN OIL AND HAS ESTABLISHED A SCHEDULE FOR PHASING-OUT THOSE EXPORTS. ANY DEVIATION FROM THAT SCHEDULE WOULD POSE SERIOUS POLITICAL DIFFICULTIES FOR THE CANADIAN GOVERNMENT. AS YOU KNOW, THE ONLY INDICATION THAT THE CANADIAN GOVERNMENT MIGHT CONSIDER A RELAXATION OF THE CURTAILMENT SCHEDULE CAME IN MINISTER GILLESPIE'S OFFER REGARDING THE WABANEX PROPOSAL; THE STATUS OF HIS OFFER IS UNCERTAIN.

IF THE CANADIANS DID AGREE TO INCREASE PRODUCTION, THEY ARE UNLIKELY TO SIMPLY ALLOW DIRECT SALES. THEY WILL PROBABLY INSIST ON A QUID PRO QUO. THERE ARE THREE POSSIBLE MECHANISMS WHICH COULD BE USED:

1) EXCHANGES OF ALASKAN OIL WITH MARITIME REFINERIES: REFINERS IN CANADA'S MARITIME PROVINCES ARE CURRENTLY COMPLETELY DEPENDENT ON FOREIGN OIL BUT WOULD UTILIZE ALASKAN NORTH SLOPE CRUDE. SUCH EXCHANGES WOULD BE PERMITTED UNDER U.S. STATUTES WHICH ALLOW EXCHANGES WITH CONTIGUOUS COUNTRIES AND WOULD MEET CANADIAN CONDITIONS FOR EXCHANGES OF DOMESTIC CRUDES. ALSO, THE COST OF DELIVERING ALASKAN OIL TO THE MARITIME IS CHEAPER THAN DELIVERIES TO THE U.S. GULF COAST SINCE NON-JONES ACT SHIPS CAN BE USED. PRELIMINARY DATA INDICATE THAT SHIPPING COST FROM VALDEZ TO THE MARITIMES VIA NON-JONES ACT VLCC'S IS APPROXIMATELY \$2.00/BBL VS. ABOUT \$2.50/BBL ON JONES ACT VESSELS FROM VALDEZ TO THE GULF COAST. AT LEAST ONE NORTHERN TIER REFINER, EXXON, LIMITED OFFICIAL USE

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HAS INDICATED TO THE CANADIANS AN INTEREST IN THIS OPTION.

2) TIME SWAPS: A SECOND OPTION WOULD BE A TIME SWAP IN WHICH U.S. REFINERS WOULD OBTAIN CANADIAN PRODUCTION NOW, IN RETURN FOR U.S. OIL AT A MUTUALLY-ESTABLISHED TIME IN THE FUTURE. THIS WOULD ALLOW FOR CONTINUED EXPORT TO THE UNITED STATES, WITHOUT LOSING THE DOMESTIC-FOR-DOMESTIC SWAP REQUIREMENT. WHILE THE TWO GOVERNMENTS COULD IN THEORY AGREE TO ISSUE THE REQUISITE EXPORT/IMPORT LICENSES, THERE IS NO GUARANTEE THAT ACTUAL COMMERCIAL EXCHANGE AGREEMENTS WOULD FOLLOW. BASED ON FEA'S DISCUSSION WITH NORTHERN TIER REFINERS, THEY ARE UNWILLING TO BUY OIL TODAY AT CURRENT WORLD MARKET PRICES, THAT WILL HAVE TO BE REPLACED IN THE FUTURE AT ANTICIPATED HIGHER PRICES. IN ANY TIME SWAPS, THEREFORE, IT IS LIKELY THAT THE GOVERNMENT OF CANADA WOULD REQUIRE USG BACKING TO INSURE THAT THE EXCHANGE PARTNERS MET THEIR OBLIGATIONS.

2) STRATEGIC STORAGE: ANOTHER POSSIBLE INDUCEMENT FOR A TEMPORARY INCREASE IN THE CANADIAN PRODUCTION WOULD BE A U.S. COMMITMENT TO SUPPLY CANADA DURING A SUPPLY DISRUPTION WITH OIL FROM OUR STRATEGIC PETROLEUM RESERVE. THE USG WOULD UNDERTAKE TO SUPPLY A PREDETERMINED QUANTITY OF OIL FROM OUR STRATEGIC STORAGE IN THE GULF OR POSSIBLY FROM WABANA, IF SELECTED, AGAINST CONTINUED FLOW TO THE NORTHERN TIER. THIS OPTION OFFERS NOTHING TO THE CANADIANS IN THE SHORT TERM FOR INCREASING PRODUCTION, EXCEPT AN INSURANCE POLICY FOR A CRUDE OIL EXCHANGE DURING A SUPPLY DISRUPTION.

NEXT STEPS

WHEN I MEET WITH THE CANADIANS NEXT WEEK AT OTTAWA TO PURSUE THE EXCHANGE ISSUE, THE U.S. NEGOTIATING STRATEGY WILL BE TO:

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1) PRESS THE CANADIANS TO ACCEPT OFFSHORE EXCHANGES;

2) IF THEY ACCEPT WE WOULD IN TURN OFFER TO RESTRICT FUTURE EXCHANGES ONLY TO THOSE REFINERIES WHICH HAVE NO SHORT-TERM ALTERNATIVES AND WE WILL UNDERTAKE TO ENSURE THAT LONG-TERM SOLUTIONS ARE IMPLEMENTED

PROMPTLY.

3) IF THEY REFUSE, EXPLORE THE POSSIBILITY OF THE ALTER-NATIVE MECHANISMS OUTLINED ABOVE. AMONG THESE ALTER-NATIVES, INCREASED CANADIAN PRODUCTION IN RETURN FOR ALASKAN OIL OR WABANA APPEAR THE MOST PROMISING.

ONCE THE DIRECTIONS OF THE CANADIAN POSITION ARE CLEAR, A TELEPHONE CALL FROM YOU OR DR. SCHLESINGER TO GILLESPIE WOULD BE IN ORDER.

I WOULD LIKE TO MEET WITH YOU, TO REVIEW THIS STRATEGY BEFORE MY DEPARTURE FOR OTTAWA, NOW TENTATIVELY SET FOR FRIDAY, JULY 29.

END TEXT: VANCE

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## Message Attributes

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**Subject:** NORTHERN TIER OIL SUPPLY - MALIN VISIT  
**TAGS:** ENRG, CA, US, (MALIN, CLEM), (SOLOMON, M)  
**To:** OTTAWA  
**Type:** TE  
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